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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 994

STANLEY E. HENWOOD, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1–5) is reported at 298 F. 2d 641. The Memorandum Decision, Findings of Fact and Conclusions of Law of the district court are reported in CCH Fed. Sec. L. Rep. ¶ 91,125.

JURISDICTION

The judgment of the court of appeals was entered on January 17, 1962. A timely petition for rehearing was denied on February 28, 1962 (Pet. 2). The petition for a writ of certiorari was filed on May 23, 1962. The jurisdiction of this Court is invoked under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa, and 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether Section 14(a) of the Securities Exchange Act of 1934, as applied through the Commission's proxy rules, is constitutionally objectionable (a) as so vague and ambiguous as to constitute an unauthorized delegation of legislative powers, or (b) as invading any right of free speech or contract.

2. Whether, in an action brought by the Commission to enjoin the solicitation of voting proxies by a Committee through the use of false and misleading communications to stockholders in violation of the Commission's proxy rules, the court may enjoin the voting of proxies obtained as a result of the unlawful solicitation, where the Committee is given an opportunity to resolicit on the basis of new and truthful communications.

STATUTE AND RULE INVOLVED

Section 14(a) of the Securities Exchange Act of 1934, 48 Stat. 895, 15 U.S.C. 78n(a), and Rule 14a–9 thereunder, 17 C.F.R. 240.14a–9, are set forth in the petition at pages 7 and 8 of the appendix.

STATEMENT

Petitioners, a group of seventeen stockholders of United Industrial Corporation ("UIC") associated together as the Stockholders' Protective Committee ("Committee"), were found to have violated Section 14(a) of the Securities Exchange Act of 1934 and the Commission's corporate proxy rules thereunder (Regulation 14) by making false and misleading statements in material distributed for the purpose of

obtaining proxies from UIC's approximately 15,000 stockholders. The proxies were to be voted at the 1961 annual meeting of stockholders. The various solicitation materials disseminated to the stockholders in the course of the Committee's contest for control of the corporation omitted to disclose the full extent of the participation of Bernard F. Gira and Herbert J. Petersen, resigned officers and directors of the corporation, in organizing and sponsoring the Committee, and in assisting it in its solicitation. The significance of the Committee's relationship with Messrs. Gira and Petersen was the focal point of the charges and countercharges in the contest for control, since they had resigned as president and executive vice president and as directors following the announcement by the corporation that discrepancies of approximately $7 million had been discovered in the corporation's accounts. The Committee had charged that the present management was at fault; the latter, in turn, accused Gira and Petersen, who had been the principal executive officers when the discrepancies were discovered. (F. I–4, II–3, III–3, III–4.) [1]

Shortly following the announcement of the substantial discrepancies in the corporation's accounts and Gira's and Petersen's subsequent resignations in January 1961, these individuals had a series of conferences with members of the law firm of Vaughan, Brandlin & Baggot. The Committee was formed as a direct result of these meetings. The Committee

[1] "F. —" refers to the district court's Findings of Fact and Conclusions of Law.

proposed, ostensibly on behalf of two of its members, Elmer M. Luther and Roy Williams, a slate of fifteen of its other members to be elected directors of the corporation. The Committee commenced soliciting proxies early in April 1961 for use at the annual meeting then scheduled for May 10, 1961.[2] Its various mailings of solicitation material to stockholders of UIC did not disclose, however, the full extent of the part that Gira and Petersen had played in the formation of the Committee.[3] (F. II–4, II–5, II–6, II–8, II–14, II–15, III–3.)

The management proposed a slate of directors and undertook the solicitation of proxies in opposition to the Committee. Late in April 1961 the management filed an action in federal district court to enjoin the Committee from using allegedly false and misleading proxy solicitation material. The Committee filed a counterclaim alleging that the management's solicita-

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[2] The meeting was several times adjourned to a later date by the management or postponed by court order, and no meeting was in fact held until May 1962.

[3] The facts developed at the trial, see *infra*, pp. 5–6, revealed that it was through the efforts of Gira and Petersen that four essential ingredients to the organizing of the proxy contest were furnished by them to the law firm: (1) stockholders other than Gira and Petersen ostensibly retained the law firm to initiate the contest, (2) a list of stockholders of UIC was made available to the law firm, (3) arrangements were made to retain a suitable public relations firm, and (4) a group of individuals prominent in the financial community were assembled as candidates for the board of directors (F. II–6).

tion material was false and seeking to enjoin its use and to invalidate the proxies that management had obtained. (F. I–4.)[4]

While the foregoing litigation was pending, the Commission on July 21, 1961, filed an action in the same district court to enjoin the Committee from continuing to solicit proxies using material alleged to be false and misleading. The corporation was made a defendant so that the court would be able to order an adjournment of the annual meeting for a suitable period during which resolicitations correcting the false statements could be conducted. On July 26 the district court entered a temporary restraining order enjoining the Committee from further solicitation and from voting the proxies already obtained. At the same time the court enjoined UIC, with its consent, from holding the stockholders' meeting and from soliciting proxies, as long as the temporary restraining order was in effect. (F. I–6, I–7, I–8.)

Following a six-week trial the district court on October 18, 1961, held that the Committee had violated Section 14(a) of the Securities Exchange Act of 1934 and the Commission's Rule 14a–9 thereunder, 17 C.F.R. 240.14a–9, by making statements in its proxy-solicitation material that were false and misleading. The court enjoined the three proxy-voting

[4] *United Industrial Corp.* v. *Henwood*, S.D. Calif., No. 747–61–JWH.

members of the Committee and Gira and Petersen from further solicitation unless appropriate disclosure in conformity with the findings of the court was made in the material. These defendants were also enjoined from voting the proxies already obtained by means of the unlawful solicitation material. In order to permit a resolicitation of those stockholders whose proxies had been invalidated, however, the court enjoined the company from holding any stockholders' meeting until after November 21, 1961. (F. III–3, III–4, III–6, III–7.)

The Committee, Gira and Petersen appealed. On November 7, 1961, the court of appeals stayed all further solicitations, and enjoined the holding of the annual meeting until further order. The appeal was expedited and on January 17, 1962, the court below affirmed the judgment of the district court with certain modifications not material here. The court upheld the prohibitions against solicitation by the Committee unless it disclosed that Gira and Petersen "were either directly or indirectly instrumental in initiating" the Committee and had participated with its representatives "in conducting proxy solicitations in opposition to the management," and against voting proxies already obtained by false and misleading solicitations. The court of appeals also enjoined UIC from holding any stockholders' meeting "until sixty days after this decree becomes final" (Pet. App. 1–5).[6] Following attempts in the court of appeals to stay the stockholders' meeting then scheduled for May 9,

[6] Following the decision of the court of appeals, the district court decided the suit which the corporation had instituted

1962, petitioners applied to this Court for a stay of the meeting. The application was denied on May 8, 1962, by Mr. Justice Douglas.

ARGUMENT

Although petitioners list thirteen questions presented, the first twelve actually resolve into the two questions discussed below. Petitioners' thirteenth question—whether the trial court's findings that Gira and Petersen covertly initiated and aided the Committee in its solicitation of proxies are sustained by the evidence—is the basic question in this litigation and, we submit, was correctly resolved by the courts below; in any event, however, further review of this factual question is plainly unwarranted. Petitioners' other contentions are without merit, and there is no conflict of decisions. Accordingly, there is no occasion for review by this Court.

1. (a) There is no merit to petitioners' contention (Pet. 18–19) that Section 14(a) of the Securities Exchange Act of 1934, 48 Stat. 895, 15 U.S.C. 78n(a), does not provide sufficiently definite standards and is therefore an unlawful delegation of a legislative function to the Commission. This Court has consistently approved comparable statutory provisions as being sufficiently definite.

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against the Committee (see pp. 4–5, *supra*) in favor of the corporation, and rejected the Committee's counterclaim. The court held that the corporation's solicitation material was not false and misleading in charging that the Committee was acting as a front for Gira and Petersen. *United Industrial Corp.* v. *Henwood*, S.D. Calif., No. 747-61-JWH.

Section 14(a) prohibits the solicitation of proxies from stockholders of corporations, the securities of which are listed on national securities exchanges, in contravention of such rules as the Commission might prescribe "as necessary or appropriate in the public interest or for the protection of investors." Pursuant to this direction the Commission has fashioned Regulation 14, which consists of eleven rules and two schedules of information required to be disclosed. Rule 14a–9, the provision which is here involved, prohibits the use of false and misleading statements in communications to stockholders. It follows the pattern of the anti-fraud provisions of the Securities Exchange Act (Section 10(b), 15 U.S.C. 78j(b), and Rule 10b–5, 17 C.F.R. 240.10b–5) and its companion statute, the Securities Act (Section 17(a), 48 Stat. 84, as amended, 15 U.S.C. 77q(a)), which make unlawful fraudulent statements in the course of buying or selling securities.

Challenges to the constitutionality of Section 14(a) similar to that made by petitioner have been rejected as having "no merit", *Securities and Exchange Commission* v. *May*, 229 F. 2d 123, 124 (C.A. 2), and as being "thoroughly shopworn", *United States* v. *Guterma*, 189 F. Supp. 265, 273 (S.D. N.Y.). The standards in Section 14(a) are no more vague than many others long approved by this Court. See, *e.g.*, *New York Central Securities Corp.* v. *United States*, 287 U.S. 12, 24; *United States* v. *Chemical Foundation*, 272 U.S. 1, 12; *Avent* v. *United States*, 266 U.S. 127, 129 (public interest); *Union Bridge Co.*

v. *United States*, 204 U.S. 364, 385 (unreasonable obstruction to navigation); *Federal Radio Commission* v. *Nelson Bros. Co.*, 289 U.S. 266, 285 (public convenience, interest, or necessity); *United States* v. *Rock Royal Co-operative*, 307 U.S. 533, 577 (other economic conditions); *Yakus* v. *United States*, 321 U.S. 414, 423 (fair and equitable and which will effectuate the purposes of the Act); *Lichter* v. *United States*, 334 U.S. 742, 778 (excess profits). See also *American Power & Light Co.* v. *Securities and Exchange Commission*, 329 U.S. 90, 104–106, where this Court upheld the standard "unduly or unnecessarily complicate the structure" of a holding company system or "unfairly or inequitably distribute voting power among security holders," established by Congress in Section 11(b)(2) of the Public Utility Holding Company Act of 1935, 49 Stat. 820, 15 U.S.C. 79k(b)(2).

(b). Petitioners' contention (Pet. 19, 22–24) that the proxy rules constitute a prior restraint on freedom of speech is equally lacking in merit. The Commission has no power of "censorship" (Pet. 19). While the Commission's proxy rules require that preliminary copies of proxy materials be filed with the Commission prior to distribution to stockholders,[6] such material may be distributed in definitive form ten days after filing, with or without the Commission's assent.[7] If the Commission deems any statements in the material to be false and misleading, its sole remedy is to seek

[6] Rule 14a–6, 17 C.F.R. 240.14a–6.

[7] *Ibid.*; see also Section 26 of the Securities Exchange Act, 48 Stat. 902, 15 U.S.C. 78z.

an injunction in district court. Thus, there is no administrative restraint. And so far as a judicial restraint is concerned, we submit that under no decision of this or any other court could an injunction issued to prevent the perpetration of a commercial fraud upon the investing public be deemed a prior restraint of the exercise of freedoms protected by the Constitution.

To petitioners' contention that the prohibition against their voting the proxies unconstitutionally violated individual stockholders' property and contract rights (Pet. 24–27), there are two answers. In the first place, the district court's decree and the court of appeals' mandate expressly provided that the stockholders' meeting be postponed long enough to permit further solicitation of proxies, so that the individual stockholders might have an opportunity to exercise their franchise on the basis of complete and accurate information. Secondly, the invalidation of the proxies obtained by the Committee at most deprived individual stockholders only of the "right" to cast their votes through proxies that had been fraudulently solicited. We suggest that there is no public or private interest—certainly none of constitutional dimensions—to be vindicated in protecting the exercise of a franchise on the basis of false and misleading statements. *See Central Foundry Co.* v. *Gondelman*, 166 F. Supp. 429, 447 (S.D. N.Y.).

2. Petitioners contend (Pet. 17, 24–27) that the court's decree restraining the voting of the Committee's proxies was not authorized by the applicable statutory provisions. The Commission's suit invoked

the equitable powers of the district court pursuant to Section 27 of the Securities Exchange Act, 48 Stat. 902, as amended, 15 U.S.C. 78aa.[a] The injunction against voting the proxies obtained by misleading statements was ancillary to the restraint against continued violations of the proxy rules. Such a decree was necessary in order to make that injunction meaningful, and to effectuate fully the statutory purpose of affording full protection to the rights of security holders. In addition, the court afforded the Committee ample opportunity to resolicit proxies in conformity with its findings, and such resolicitation, had it been undertaken, would have provided the stockholders with an adequate means of exercising their franchise.

Injunctions against the use of proxies obtained through violation of the proxy rules, together with the postponement of a stockholders' meeting to permit a suitable resolicitation, have been held to be proper forms of relief in suits in equity under Section 27. *Securities and Exchange Commission* v. *May*, 134 F. Supp. 247 (S.D. N.Y.), affirmed, 229 F. 2d 123 (C.A. 2); *Central Foundry Co.* v. *Gondelman*, 166 F. Supp. 429, 446 (S.D. N.Y.); *Securities and Exchange*

[a] Section 27, as here pertinent, provides:

"The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder."

Commission v. *Transamerica Corp.*, 67 F. Supp. 326 (D. Del.), modified and affirmed, 163 F. 2d 511 (C.A. 3), certiorari denied, 332 U.S. 847; *Securities and Exchange Commission* v. *Okin*, 58 F. Supp. 20 (S.D. N.Y.); *Securities and Exchange Commission* v. *O'Hara Re-election (or Proxy) Committee*, 28 F. Supp. 523 (D. Mass.). Such injunctive relief to effectuate statutory provisions is neither improper nor unusual. Compare *Mitchell* v. *DeMario Jewelry*, 361 U.S. 288, 291; *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 398; *Deckert* v. *Independence Corp.*, 311 U.S. 282, 288; *Los Angeles Trust Deed & Mortgage Exchange* v. *Securities and Exchange Commission*, 285 F. 2d 162 (C.A. 9) certiorari denied, 366 U.S. 919.

There are no conflicting court of appeals decisions regarding the power of courts to enjoin the voting of proxies obtained pursuant to unlawful solicitations. In the *Transamerica* case, *supra*, the management had violated the Commission's proxy rules by failing to bring before the stockholders certain proposals of a stockholder, and there was no claim that the material contained false and misleading statements relevant to election of directors. The court enjoined the use of the proxies for any purpose except the election of directors (67 F. Supp. at 329). The other federal court decision cited by petitioners in this connection (Pet. 22) also upholds the power exercised by the court below. As is made clear in the *Okin* case, *supra*, 58 F. Supp. at 21, 25, the district court enjoined the voting of proxies solicited with material containing false and misleading statements.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ARCHIBALD COX,
Solicitor General.

PETER A. DAMMANN,
General Counsel,
WALTER P. NORTH,
Associate General Counsel,
FRANK E. KENNAMER, JR.,
Assistant General Counsel,
JOHN A. DUDLEY,
DONALD R. JOLLIFFE,
Attorneys,
Securities and Exchange Commission.

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